



**The Comptroller General  
of the United States**

Washington, D.C. 20548

## **Decision**

**Matter of:** Claim of Nebraska Aluminum Castings, Inc.--  
Second Request for Reconsideration  
**File:**  
**Date:** B-222476.9  
March 16, 1988

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### **DIGEST**

1. A solicitation provision advising that progress payments prior to first article approval would be limited to the first article price assumes that first article pricing will bear some reasonable relationship to the properly allocated costs of producing and testing the first articles.
2. Prior to first article approval a contractor bears the risk of its inability to produce an acceptable product; a bid that would shift this risk to the government may be rejected.
3. Where tooling and equipment needed to produce an acceptable first article are also needed for the production quantity, the costs of such tooling and equipment should be amortized over the entire contract quantity.
4. The Cost Accounting Standards constitute the principal source of authority for measuring and allocating costs under government contracts.

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### **DECISION**

Nebraska Aluminum Castings, Inc. (NAC), requests further reconsideration of our denial of its claim under 31 U.S.C. § 3702 (1982) for bid preparation, protest, and other costs incurred in connection with invitation for bids (IFB) No. DAAK01-85-B-B060, issued by the Department of the Army for field compasses. We denied NAC's claim in Nebraska Aluminum Castings, Inc.--Claim, B-222476.6, et al., Sept. 15, 1987, 87-2 CPD ¶ 249, aff'd, B-222476.8, Dec. 2, 1987, 87-2 CPD ¶ 533. Upon further review, and for the reasons discussed below, we reaffirm our denial of the claim.

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The IFB sought separate line item prices for a production quantity of just under 100,000 compasses and 10 first article, preproduction models. The solicitation provided that unless the agency waived first article testing, the contractor would be required to submit a test report to the agency within 225 days of award. If the contracting officer approved the first articles based on the report, the contractor would retain the first articles throughout production to serve as a standard of acceptability. If the first articles were not approved, the contract would be subject to termination for default. See Federal Acquisition Regulation (FAR) § 52.209-3.

The IFB also provided for the government to provide contract financing in the form of progress payments. The Progress Payments clause described the terms under which such financing would be available. FAR § 52.232-16. The solicitation provided further that prior to first article approval no progress payments would be made in excess of the first article price.<sup>1/</sup>

NAC's price for the production quantity was \$19.17 per compass, while its price for the 10 first articles was \$22,510 each. The Army rejected NAC's bid after determining that it was materially unbalanced with respect to pricing of the first articles. In so doing, the Army relied on our holding in Riverport Industries, Inc., 64 Comp. Gen. 441 (1985), 85-1 CPD ¶ 364, aff'd, B-218656.2, July 31, 1985, 85-2 CPD ¶ 108, in which we said that a bid containing a grossly front-loaded price for first articles should be viewed as materially unbalanced and therefore rejected, even if lowest overall, since acceptance of the bid would be tantamount to allowing an advance payment, a form of contract financing not provided for under the terms of the solicitation.

We denied NAC's protest of the Army's action in Nebraska Aluminum Castings, Inc., B-222476, June 24, 1986, 86-1 CPD ¶ 582, aff'd, B-222476.2, Sept. 23, 1986, 86-2 CPD ¶ 335, B-222476.3, Nov. 4, 1986, 86-2 CPD ¶ 515. We agreed that NAC's bid was unbalanced based on our review of cost data NAC submitted to this Office. NAC's data showed that the firm contemplated spending \$121,000 for what it termed "contract tools," a category that included various dies, molds, jigs, and fixtures. NAC had allocated the entire \$121,000 to the first 150 days of contract performance and had listed no amount for contract tools for the remaining 660 days allowed for final delivery of all items required under the contract. Further, NAC had allocated to the first

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<sup>1/</sup> First Article clause, Note 2.

120 days of contract performance a total of \$72,242 for "special equipment," such as a coordinate measuring machine, a liquid scintillation system, and a lathe. For each remaining 30-day period until contract completion, NAC had allocated \$1,433 to this category. From our review of NAC's data, it appeared that the firm had assigned to the first few months of contract performance, and in turn to the 10 compasses to be produced during that time, most of the costs it expected to incur to buy or lease the equipment it would need to perform the entire contract.

In requesting further reconsideration of our denial of its claim, NAC contends that our prior decisions in this matter effectively ignored the requirements of the FAR that an IFB identify price-related factors that will be considered in evaluating bids, FAR § 14.201-5(c), and that award be made to the responsible bidder whose bid, conforming to the terms of the IFB, is most advantageous to the government, based solely on price and the price-related factors identified. FAR § 14.407-1(a). NAC points out that the IFB in this case did not identify balanced first article pricing as an evaluation factor and that the firm's bid otherwise complied fully with the requirements of the IFB. NAC argues that it was not seeking unauthorized contract financing, but did expect to receive the progress payments for which the solicitation provided. In this connection, NAC notes that FAR § 32.504(b) states that a "contractor's request for progress payments may include the full amount paid to subcontractors as progress payments." NAC says that it intended to acquire its special tooling and equipment from subcontractors, and that it would have made progress payments to them. Finally, NAC has asked this Office to calculate, using the cost data previously provided to us, exactly what the firm should have bid for the first article line item.

The most important issue from NAC's perspective is the failure of the IFB to state explicitly that first article pricing must be balanced and that a bid containing materially unbalanced first article pricing would be rejected. In this regard, we recognize that the IFB contained no mention of unbalanced pricing. Nevertheless, we do not think that a bidder reasonably could have read the solicitation as permitting the pricing scheme submitted by NAC.

As indicated earlier, the solicitation provided that progress payments prior to first article approval would not exceed the first article price. This provision was designed to limit the government's financial exposure under the contract until such time as the contractor had shown that it was capable of satisfactory contract performance. In our view, the provision cannot be read as indicating that the

government would make progress payments up to the first article price regardless of amount. Rather, we think the provision assumes that first article pricing would bear some reasonable relationship to the properly allocated costs of producing and testing the first articles. While this assumption was not expressly stated and labeled as a requirement for balanced pricing, any reading of the provision without such an assumption would have exposed the government to the very risk the government obviously wished to avoid: the payment of substantial progress payments to a contractor that had not yet proven its ability to perform. The Army properly rejected NAC's bid because the bid sought contract financing on terms other than those contemplated by the IFB.

The IFB provided that a contractor's failure to receive first article approval would be grounds for a default termination. This provision clearly evidenced the government's intent that the contractor bear the risk of its inability to produce an acceptable product. Under NAC's pricing scheme, however, some of this risk would shift to the government if, as NAC suggests would occur, substantial progress payments were made prior to first article approval. NAC's bid sought to alter the risk allocation reflected in the solicitation, and therefore was subject to rejection.

NAC has argued that if the government had made progress payments to the firm based on the first article price submitted, the government's interests would have been protected because it would have obtained title to NAC's special tooling and equipment. The Progress Payments clause contained in the IFB provided at paragraph (d) that the government would acquire title in:

"(ii) Special tooling and test equipment to which the government is to acquire title under any other clause of this contract; [and]

"(iii) Nondurable (i.e. noncapital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids, title to which would not be obtained as special tooling under subparagraph (ii) above."

With respect to special tooling, we are not aware of any other clause in the IFB here that would have given the government title. In fact, FAR § 45.306-2 provides that since competition generally results in fair charges for amortizing special tooling costs, the government usually does not take title to special tooling in competitive acquisitions. Concerning subparagraph (iii), it does not seem that NAC's tooling can be regarded as "nondurable,"

since the firm's own data indicate that the tooling purchased in the first few months of contract performance was expected to be used, without replacement, throughout the entire 27-month contract.

It is not necessary--nor indeed possible on the record before us--for us to determine precisely what NAC should have included in its price for the first articles. As we stated in Riverport Industries, Inc.--Request for Reconsideration, B-218656.2, July 31, 1985, 85-2 CPD ¶ 108, the rule in Riverport was intended to apply only where the bidding scheme, viewed as a whole, is grossly unbalanced mathematically. The rule does not require strict adherence to any prescribed pricing formula, but should be invoked only in cases where the contracting agency determines that first article pricing bears no reasonable relationship to the costs of producing and testing the first articles. In this connection, while the costs of any special process involved in producing the first articles, and the costs of testing them, properly may be included in first article pricing, a bidder's costs in acquiring tooling and equipment should be amortized over the entire contract quantity where those costs are related to the firm's performance of the entire contract--that is, to the furnishing of the production items as well as the first articles.

NAC has pointed out that there was no guidance available to it when it was preparing its bid as to the proper allocation of costs for first article pricing purposes. In this regard, we recognize that the Cost Accounting Standards (CAS), which constitute the principal source of authority for measuring and allocating costs under government contracts, are not mandatory for contracts entered into pursuant to sealed bid procedures. Nevertheless, the CAS do provide guidance concerning such matters as when the costs of tangible assets must be capitalized, CAS 404, and how the costs of capital assets are to be allocated to cost objectives. CAS 409. At the time NAC was preparing its bid, the CAS could be found at 4 C.F.R. §§ 400-420 (1984).<sup>2/</sup> In any event, aside from the guidance contained in the CAS, we think it should have been evident that proper accounting would not permit the allocation of most of the costs of a production line to the first few items produced.

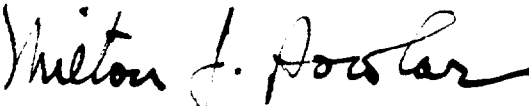
We can appreciate the dilemma NAC faced in this procurement: it could not produce the first articles without a substantial investment of capital, yet was entitled to receive progress payments only up to its first article price.

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<sup>2/</sup> The CAS currently are codified at FAR Part 30. Federal Acquisition Circular 84-30, Sept. 22, 1987.

NAC's solution was to submit a price for the first articles roughly equivalent to the firm's anticipated out-of-pocket costs for producing the first articles. Under this approach, however, the price charged for each first article was 1000 times the price charged for each production unit, even though the first articles and production units would be identical. This evidenced a gross deviation from normal product costing and resulted in a pricing structure under which the contract financing provided by government would have exceeded the level contemplated by the IFB. In addition, the government would have been required to pay nearly 11 percent of the total contract price upon first article approval at a time when the contractor would not have delivered anything of value, but merely would have demonstrated that it was capable of commencing contract performance. In view of the well-established principle that the government pays only for value received, 31 U.S.C. § 3324 (1982), we think the Army properly rejected NAC's bid.

Our denial of NAC's claim is affirmed.

  
for Comptroller General  
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